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AUDIT OF THE MAYOR'S 2006-2007 PROPOSED BUDGET

THE AUDITOR GENERAL'S MESSAGE

April 25, 2006

TO THE HONORABLE CITY COUNCIL:

I consider it an honor to have been chosen to execute the duties of Auditor General for the City of Detroit. I will do my best to make you proud of your selection.

This is my first opportunity to present to you, in accordance with your request, the audit report of the proposed budget, for the upcoming fiscal year, as prepared by the Honorable Mayor of the City of Detroit. This message is brief.

All of the members of the Auditor General's team of professional and skilled auditors participated in the audit. We worked many overtime hours, including nights and weekends, to complete the audit procedures necessary to satisfy the requirements of the audit process.

In the following pages you will see what a tremendous job the audit team has done, within a very short period of time, analyzing the Mayor's budget calculations, projections, commentary, conclusions and recommendations.

Considering the fact that the City of Detroit has financial problems that do not appear to be diminishing to any great extent, there are some budget matters that I would like to highlight for your serious consideration. Then, we will present the audit of the Mayor's budget for the fiscal year 2006-2007.

The few points that I shall make, hopefully, will result in some positive action in the near future to deal more effectively with the City's financial issues.

THE OFFICE OF THE AUDITOR GENERAL

I believe that the Office of the Auditor General (OAG) is understaffed. The budget for fiscal year 2006-2007 is to be funded in the amount of \$2,646,162. This amount would include 21 positions, funding for up to 34 reports on audits of financial transactions, performance audits, and special requests, 80 or more hearings regarding claims made by citizens, and other valuable services that are to be provided. We requested the Mayor approve 23 positions versus 21. We believe that it would be counterproductive to implement a budget reduction in our staff.

The OAG has identified, in the past, several millions of dollars in fraudulent transactions, and has made recommendations resulting in millions of dollars in annual savings for the City.



Considering the status of Detroit's financial condition, the OAG's audit staff is needed now more than ever.

We do need to eliminate functions and policies that do not contribute to the City's mission. On the other hand, the City's internal audit function cannot withstand a loss of personnel at this time due to the value of having the OAG's services at full strength.

Each audit organization performing audits and/or attestation engagements in accordance with Generally Accepted Government Auditing Standards (GAGAS) should have an appropriate internal quality control system in place and should undergo an external peer review. The "peer" should be a firm that conducts governmental audits of a municipality the same as we do.

The "peer" would review our work papers generated during the audits that we conduct in order to determine if we are following the appropriate audit procedures. It is my understanding that the OAG for the City of Detroit has not had a peer review in quite some time.

The OAG is a member of the National Association of Local Government Auditors, whose acronym is N.A.L.G.A. The peer review should take place sooner rather than later because of the professional benefits. The cost is minimal, due to our membership in N.A.L.G.A.

For every audit that we conduct we must execute a disclaimer to the effect that we have not had our required peer review as the rules mandate. We intend to take steps to correct this "oversight" as soon as possible.

RISK MANAGEMENT

The City of Detroit has implemented a self-insurance plan rather than paying for insurance coverage provided by a commercial carrier for personal injuries, automobile damages, slip-and-fall accidents, and other kinds of incidents, or catastrophes, that would inflict damage on others for which the City would be liable.

The OAG is suggesting strongly that the City look very carefully at the practices and procedures that govern the operation and financing of the Risk Management Fund and that it is fully coordinated to ensure that its goals are met, and that payments from the liabilities that arise, when the City is at fault, can be paid timely, and hopefully, without the incurrence of add-on costs that frequently occur when legal claims are paid later rather than sooner. That is not to say that legal claims should be paid in haste. A careful review is always in order when claims are made for settlement due to injuries/damages inflicted.

The Risk Management Fund serves a valuable purpose in its self-insurance role for the City, having been established by City Ordinance No. 16-95 in the year 1995.

Ideally, the Fund should enable the City to reduce some of the costs for which the fund was established.



The proceeds from the sale of bonds have been the source of funding for the Risk Management Fund. As long as the proceeds from the sale of bonds within the Fund are managed with prudence, the costs to issue the bonds and invest and manage the proceeds prudently for the intended purpose, the City should benefit from this method of paying for damages inflicted.

BORROWING

The City sells Revenue Anticipation Notes (RAN) and Tax Anticipation Notes (TAN) to pay short-term debts. The money borrowed from the sale of the notes is paid to satisfy shortfalls in cash due to reductions in income, property and other taxes, water, sewerage disposal, parking fees, and miscellaneous other sources.

The problem is that cash flow is diminishing each year from the loss of tax paying residents, increasing costs of salaries, fringe benefits, vehicles, and other goods and services utilized by the City. The pain is intensified due to the high cost of fringe benefits provided to City employees.

Principal and interest repayments on these annual short-term borrowings are leading to our financial demise due to our obligation to repay the obligations on an annual basis. It would be of no benefit to lengthen the term during which the debt repayment would be extended.

For each year that we incur this short-term debt the repayment is more painful than the previous year. Why is that so? For each year that passes, the revenues received during the year of repayment have diminished by the due date of principal and interest to the point that it challenges the City's ability to make the repayment. At some point in time we may not be able to repay without suffering substantial financial shortfalls with respect to these short-term debts that may require annual renewal to pay the prior year's borrowing.

The annual RAN/TAN sale requires some serious attention or else the cost of borrowing will cancel the benefits to some extent.

In fiscal year 2004-2005, the City borrowed \$2,375.3 billion via sales of bonds, notes, purchases of vehicles, and Pension Obligation Certificates. The money was used to pay obligations owed, but these debts are burdensome obligations and must be contended with very carefully.

Our in-depth audit report follows.

Respectfully submitted,

Loren E. Monroe
Auditor General